

Memorandum

Date: December 10, 2003

To: Finance Plan Independent Review Panel

From: Patrick Wright, Director
Kate Hansel, Assistant Director

Subject: BDA Response to Finance Panel Comments

We would like to thank the Panel again for their participation in the Bay-Delta Authority finance planning process. The Panel provided helpful guidance at the November 18th meeting and in their Panel memo dated December 10. The Panel meeting was a success in terms of airing the complex issues facing BDP financing, and in receiving input and direction from the Panel. This memo contains our response to the Panel memo regarding the BDA Framework and Issues Report and the Finance Options Report.

Before laying out our thoughts on how we can best integrate the Panel's comments into the Framework, it may be beneficial to reiterate some context. The BDA is aware that the scope of this topic is very broad and complex. We also realize that there are significant information gaps at this time. Despite these challenges, the BDA sees the Finance Options Report as an important opportunity to describe what we do (and do not) know about potential benefits and costs, and provide examples of finance options for all BDP elements. We believe a review and description of expected benefits and costs for BDP investments will help promote fruitful dialog and inform policy makers involved in upcoming finance decisions. This is a particularly time-sensitive task, as the information developed through this effort will be useful to the State legislature in their FY 2004-05 budget deliberations and for the Federal administration and Congress as they continue to consider federal authorization for the Program. For this reason, the BDA believes it is important that it provide a program-wide Finance Options Report by Spring of 2004.

The Panel provided specific comments to BDA and the Technical Team in the following general categories: 1) provide greater context for developing finance options; 2) develop alternative approaches to funding/financing; 3) produce a first-order test of benefits; and 4) consider evaluating multiple baselines. Our responses to each are as follows:

- 1) *Provide greater context for developing finance options.* The Panel recommends including additional background information in a Finance Options Report to provide the appropriate context for the analysis. We support this recommendation and will include the following information in the beginning of the Report: Bay-Delta Program past and future costs, historical water financing practices, the current fiscal and political realities affecting water financing, and how those realities could affect the status quo method of financing for the Bay-Delta Program.
- 2) *Develop alternative approaches to funding/financing.* The Panel suggests developing and applying three to four alternative approaches to cost allocation to illustrate the likely effects of applying the different methods. The Panel provided three approaches to consider: a Public Goods approach, a Benefits approach, and a Stand-Alone/Separable cost approach. BDA welcomes the suggestion to explore and illustrate different approaches to allocate joint costs and will work with the Panel to describe and evaluate various approaches. However, it is important to note that because of the broad diversity of activities and type of benefits derived, we do not expect that any single approach can be applied effectively across all BDP activities. As described in the Framework and Issues Report, a major issue to be addressed in our analysis is the difficulty of quantifying and distributing joint costs for many of the program elements. In these situations we expect to evaluate various options that can reasonably be supported based on the availability of relevant data. We would like to work with the Panel to further identify and clarify alternative cost allocation approaches that may be practical given the limited data we expect to have to work with. It is our sense at this time that this follow-on discussion may prove most fruitful once we have had an opportunity to collect additional cost and benefit data for each program element.
- 3) *Produce a first-order test of benefits.* The Panel suggests and BDA agrees with the comments regarding description and quantification of benefits. The BDA will identify what we know and what we don't know regarding expected benefits and beneficiaries for potential investments to meet program objectives. The first step in this process is describing the expected physical changes for each investment action. The economic benefits that result from these physical changes will vary based on beneficiary group and baseline perspective. BDA intends to closely involve the Ad Hoc Workgroup (our stakeholder and agency group) in this process.

- 4) *Consider evaluating multiple baselines.* BDA agrees with the Panel's observation regarding the sensitivity of the baseline issue and the need to propose alternatives that reflect different stakeholder views of baseline. Therefore, we will be working with stakeholders to determine exactly what the baseline issue means to different stakeholders, and how financing and cost repayment might be affected. However, it is our current thinking that issues related to different baseline views can be addressed more effectively at the end of the analysis rather than at the beginning.

At this time, it is our thinking to focus first on describing the expected physical changes that would result from potential investments. We expect the description of these physical changes will not depend significantly on the different baseline perspectives. After describing expected physical changes, we will identify potential benefits and beneficiaries. Again, given the joint nature of most of these programs and the information currently available, our qualitative description of benefits likely will not change based on different baseline perspectives (other than whether a change is a benefit or a mitigation).

To inform future baseline discussions, we plan to describe how these differing perspectives can be addressed during the final step of cost repayment. We can show several examples of how expected costs to produce desirable physical changes can be reallocated based on different baseline perspectives. The BDA would like to work with the Panel to refine an approach to address this sensitive issue during the coming months, as we compile the currently available data.

The BDA and Technical Team look forward to continued work with the Panel on the long-term financing of the Program. In the near-term, we hope to arrange several conference calls with the Panel in December and January to continue refining a useful Framework for analysis. We believe it may be most useful to provide an initial analysis of finance options for several program elements to the Panel for review and comment at a Panel meeting in February 2004. A Final Finance Options Report including all program elements would be prepared for Panel review in April 2004. Throughout the process, BDA and the Technical Team will work jointly with the Ad Hoc Work Group and the Panel.